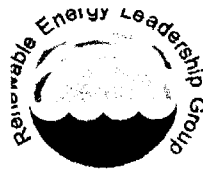


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The Renewable Energy Leadership Group
10631 E. Autumn Sage Drive
Scottsdale, AZ 85255-8830
Phone: 480-563-4109
Fax: 480-563-4507

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Arizona Corporation Commission

DOCKETED

NOV 17 2003

Chairman Marc Spitzer
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007



Dear Chairman Spitzer:

In mid-August 2003 ten members (Attachment A) of the Cost Evaluation Working Group (CEWG) wrote to the Commissioners recommending that Option 2 in the CEWG Report be approved. The CEWG Report shows the cost of environmental portfolio electricity has declined sufficiently that the cost/benefit point derived in the Report can be used by the Commission to justify continuing the annual increase in the portfolio. Since our first letter, three actions have occurred that cause us to re-state our recommendation:

1. Commissioner Mundell wrote to the other Commissioners requesting that the Commission prepare to decide whether to continue the scheduled EPS percentage increase to 1.1% by discussing the issue at an upcoming staff meeting and then making a final determination at an Open Meeting.
2. Chairman Spitzer presented a proposal with three changes to the Rule "that would be reviewed in a special rulemaking process with full stakeholder input":
 - a. Return System Benefit Charge funds to energy efficiency purposes;
 - b. Increase EPS funding by raising certain rates; and
 - c. Remove "Multipliers" for all new projects.
3. A special Open Meeting/Workshop on October 6, 2003 included presentations by Commission Staff on the CEWG Report and by proponents of Options 1 and 2. Other comments by public stakeholders on the Report were also presented.

After a detailed analysis, we conclude that Chairman Spitzer's proposal will have the following impacts:

- **Doubling the EPS Surcharge funding caps while re-allocating funds to DSM will result in a substantial decrease in EPS funding – not an increase.** The Chairman's proposal is an effort to respond to the conclusion that there are insufficient funds for Arizona utilities to meet the EPS goal of 1.1% by 2007; in effect, he proposes that EPS funding can be increased by doubling the "caps" for each of the three customer categories that pay the Surcharge. This action, taken together with his proposal to return System Benefit Charge (SBC) funds to energy efficiency purposes, results in a net EPS funding decrease. Our conclusion is supported by Attachment B based on Tables II 1 & 2 (pg. 13) of the CEWG Report supplemented by 2002 billing data from Tucson Electric Power and Arizona Public Service. **Surcharge funds are not doubled by doubling the caps because many customers in the residential and commercial categories (who pay the bulk of Surcharge funds) do not reach the caps at their existing levels.** The impact of doubling the caps and returning all SBC funds to energy efficiency purposes results in net EPS fund reductions of \$1.4 million per year for TEP and \$2.7 million for APS. We have added another column that illustrates the effect of doubling the caps and increasing the Surcharge to \$0.00175/kWh consumed to provide an alternative approach that would increase net available EPS funds.
- **The CEWG Report cited a benefit related to Navopache's creative use of EPS funds to satisfy RUS loan repayment requirements. This benefit may be diminished if some of the funds planned to repay the loan are not available.**
- **Removing the multipliers for all new projects will result in an increase in the solar electric kWh required to meet the EPS.** The increase in kWh requires more installed solar thereby exacerbating the funding problem. The extra credit multipliers were created after years of analysis and negotiation as a way to encourage early installations (this multiplier ends in 2003); promote in-state solar manufacturing and installation; and provide an incentive for solar electric projects installed at or on the customer premises in Arizona. For every kWh installed under these categories, a benefit in terms of extra kWh – up to 2.5 times – for meeting the EPS goal was allowed. The intent of the multipliers was to promote solar electric installations using Arizona's most abundant resource and cause project installation costs to drop – the CEWG Report demonstrates this approach is working. Rather than remove the multipliers, we propose that other renewable technologies not yet competitive with conventional options, such as small wind, that could most benefit from the multipliers be included as technologies qualifying for the multipliers. Such actions could be taken on a waiver basis.

In this context, additional renewable generation can be encouraged by addressing large wind and other renewable technologies that are competitive with conventional generation options, such as landfill gas, in the APS rate case now

before the Commission, other rate cases as they are submitted, and evolution of the Track B generation procurement process.

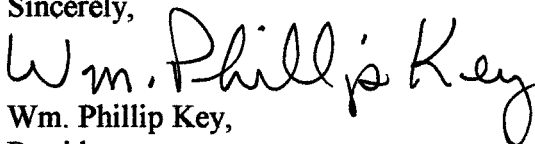
- **Possible policy changes related to the level of EPS funding are already causing a loss of market certainty.** TEP has placed a hold on a 50 kW solar electric project under development with the City of Tucson and Navopache is reviewing the RUS financed project described above. Combined, these projects amount to millions of dollars and commitments by many industry stakeholders.

Commissioner Mundell's October 3, 2003 letter states his interest in "ensuring that we are making the best level of progress in moving Arizona toward the use of viable and appropriate renewable sources of energy". We share this view, and CEWG members are actively involved in workshops on net metering, environmental mitigation, Track B progress, and Demand Side Management.

All the CEWG members endorsing this letter support energy efficiency and believe the utilities should have viable programs to help customers conserve electricity. Rather than undermine the EPS funding through a process that would almost certainly require a re-opening of the EPS Rule, we suggest that energy efficiency policies and programs be examined by the Commission in a timely manner during other proceedings, e.g., as a separate docket or rulemaking potentially initiated as a result of the ongoing Demand Side Management (DSM) workshops, and/or in individual rate cases. This approach keeps the successful EPS policy and current Rule separate from examination of energy efficiency policies, programs, and funding mechanisms.

We recommend that the CEWG Report be used for the purpose originally stated in the Rule adopted in 2001 – determine if an acceptable cost/benefit factor has been established that can be used by the Commission to justify continuing the annual increase in the portfolio percentage. The next step in this process is to move the EPS to the 1.1% level as provided in the EPS as quickly as possible. Our recommendation that Option 2 be approved is based in part on provisions that increase the funds available to the utilities for meeting the EPS goal. These provisions would not cause the Rule to be re-opened and can be done through individual actions with the utilities. Above all, Option 2 maintains the very positive momentum of this successful public policy effort as documented in the CEWG Report. Our conclusion after listening to all the comments made at the October 6 Open Hearing/Workshop is that Option 2 is the better choice for Arizona electricity consumers.

Sincerely,



Wm. Phillip Key,
President

ATTACHMENT A

| <u>ORGANIZATION</u> | <u>REPRESENTATIVE</u> |
|--|------------------------------|
| Arizona Clean Energy Industries Alliance | Robert "Bud" Annan |
| Arizona Solar Energy Industries Association | Michael Neary |
| Grand Canyon Trust | Rick Moore |
| Kyocera Solar, Inc. | Cecilia Aguillon |
| Land and Water Fund of the Rockies (now Western Resource Advocates) | David Berry |
| Navopache Electric Co-op., Inc | Dennis Hughes |
| Renewable Energy Leadership Group | Phil Key |
| Sierra Club, Grand Canyon Chapter | Sandy Bahr |
| Southwest WindPower | Andy Kruse |

ATTACHMENT B

| 2002 (Note 1) | | | | | | |
|-------------------------------|---------------------|---------------------|----------------------|------------------------|----------|--------------------------------|
| | <u>A</u> | <u>B</u> | <u>C</u> | <u>D</u> | | <u>E</u> |
| | EPS Funds | Retail Energy Sales | Effective | Utility Funds Impact | | Caps Doubled & Surcharge |
| <u>Tucson Electric Power</u> | <u>Collected</u> | | <u>Rate (\$/kWh)</u> | <u>If Caps Doubled</u> | <u>2</u> | <u>Doubled to \$.00175/kWh</u> |
| <u>Surcharge Category</u> | | | | | | |
| 1. Residential | \$1,205,956 | 3,186,726 | 0.000378 | \$1,915,956 | 3 | \$2,411,913 |
| 2. Small Commercial | \$1,201,431 | 1,867,007 | 0.000644 | \$1,451,431 | 3 | \$2,402,861 |
| 3. Large Commercial | <u>\$31,746</u> | <u>2,956,684</u> | 0.000011 | <u>\$63,492</u> | 4 | <u>\$63,492</u> |
| Surcharge Subtotal | \$2,439,133 | 8,012,417 | | \$3,430,879 | | \$4,878,266 |
| Systems Benefit Charge | <u>\$2,440,000</u> | | | <u>\$0</u> | | <u>\$0</u> |
| TEP Subtotal | \$4,879,133 | | | \$3,430,879 | 5 | \$4,878,266 |
| | | | | | | 6 |
| <u>Arizona Public Service</u> | | | | | | |
| <u>Surcharge Category</u> | | | | | | |
| 1. Residential | \$3,101,375 | 10,447,596 | 0.000297 | \$5,264,790 | 3 | \$6,202,750 |
| 2. Small Commercial | \$3,439,219 | 10,338,456 | 0.000333 | \$4,487,691 | 3 | \$6,878,438 |
| 3. Large Commercial | <u>\$31,151</u> | <u>2,575,703</u> | 0.000012 | <u>\$62,302</u> | 4 | <u>\$62,302</u> |
| Surcharge Subtotal | \$6,671,745 | 23,361,756 | | \$9,814,783 | | \$13,143,491 |
| Systems Benefit Charge | <u>\$6,000,000</u> | | | <u>\$0</u> | | <u>\$0</u> |
| APS Subtotal | \$12,671,745 | | | \$9,814,783 | 5 | \$13,143,491 |
| Policy Totals | <u>\$17,480,878</u> | | | <u>\$13,245,662</u> | 5 | <u>\$16,021,757</u> |

NOTES:

- Columns A & B from Tables II - 1&2, pg. 13 of CEWG Report; Systems Benefit Charge lines in Columns A & B from Tables A1 - 1&2, pgs. 53 & 56; Columns A & B based on Surcharge rate of \$0.000875/kWh and Caps of \$0.35/mth for residential meters; \$13/mth for small commercial meters; and \$39/mth for large commercial meters. Column C calculates the 2002 effective Surcharge Rate for each ratepayer category.
- The Spitzer proposal predicts that if the caps are doubled, EPS funding is doubled. In fact, this does not occur because some ratepayers are not reaching the caps now. Simply doubling the caps will mean fewer ratepayers will reach the new cap except the mines and large commercial electricity consumers who will cap out even if their cap is raised significantly, but still not contribute a fair share of funds.
- Data from TEP and APS analyses that doubles caps based on actual billing of customers for EPS in 2002.
- Under the proposal that only doubles the caps, the Mines and large commercial ratepayers still pay a very small portion of the EPS costs.
- Doubling the caps and returning all SBC funds back to energy efficiency programs actually reduces available funds for EPS policy.
- Doubling the caps and increasing the Surcharge rate to \$0.00175/kWh consumed keeps total EPS funds roughly equivalent to 2002 amounts. Mines and large commercial users still pay a small amount because they have only a few meters in spite of their large electricity consumption.